

Message Text

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INFO ALL EC CAPITALS

C O N F I D E N T I A L SECTION 01 OF 03 BRUSSELS 06299

LIMDIS

USEEC

PARIS ALSO FOR OECD

E.O.11652:GDS
TAGS: EFIN, EEC
SUBJECT: EC MONETARY COMMITTEE DISCUSSES BALANCE OF
PAYMENTS ADJUSTMENT

1. SUMMARY: THE EC MONETARY COMMITTEE DISCUSSED BALANCE
OF PAYMENTS ADJUSTMENT PROBLEMS AT ITS MEETING THE
MORNING OF JUNE 9. SERVING AS A BASIS FOR THE DISCUSSION,
A COMMISSION PAPER POINTED OUT THE NEED FOR THE EC TO
ACCEPT A SUBSTANTIAL PORTION OF THE DEFICIT COUNTERPART
OF THE OPEC CURRENT ACCOUNT SURPLUS, SUGGESTED A NORMATIVE
DISTRIBUTION OF POSITIONS AMONG EC MEMBER STATES, AND
ARGUED THE NEED FOR ACTIVE POLICIES, INCLUDING EXCHANGE-
RATE POLICIES, TO ACHIEVE THIS GOAL. MEMBER STATE
REPRESENTATIVES CHALLENGED THE COMMISSION'S ANALYSIS ON
SEVERAL GROUNDS, AND GENERALLY REJECTED ITS TENTATIVE
POLICY CONCLUSIONS. END SUMMARY
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2. THE EC MONETARY COMMITTEE, MEETING DURING THE
MORNING OF JUNE 9, HELD A BROAD DISCUSSION ON BALANCE OF
PAYMENTS ADJUSTMENT AMONG EC MEMBER STATES. THE
DISCUSSION WAS UNDERTAKEN AS A FIRST STEP IN THE CON-
SULTATION PROCEDURE WHICH THE COMMITTEE PROMISED IN ITS
GENERALLY NEGATIVE REPORT TO THE COUNCIL ON THE

DUISENBERG TARGET ZONE PROPOSAL.

3. AS A BASIS FOR THIS DISCUSSION, THE COMMISSION PROVIDED A PAPER ENTITLED "EXCHANGE RATE POLICY AND THE ADJUSTMENT PROCESS: RECENT EXPERIENCE AND FUTURE PROSPECTS IN THE MAJOR COMMUNITY COUNTRIES." WE HAVE OBTAINED ON A HIGHLY CONFIDENTIAL BASIS, A COPY OF THIS PAPER, AS WELL AS A COPY OF THE OFFICIAL "DETAILED MINUTES" OF THE MEETING. BOTH DOCUMENTS ARE BEING POUCHED TO EUR/RPE, ROBERT GELBARD. FOLLOWING ARE OUR SUMMARY TO THE PAPER AND AN ACCOUNT OF THE DISCUSSION BASED ON SEVERAL SOURCES.

4. THE COMMISSION'S PAPER BEGINS BY SUGGESTING FOR MEMBER STATES NORMATIVE CURRENT ACCOUNT POSITIONS TO BE AIMED AT IN THE MEDIUM TERM. THE OPEC CURRENT ACCOUNT SURPLUS IS ASSUMED TO REMAIN LARGE - ON THE ORDER OF \$30-40 BILLION A YEAR (AT 1976 PRICES) FOR SOME YEARS TO COME. NON-OIL EXPORTING LDCS AND THE SMALLER NON-EEC OECD COUNTRIES WILL NEED TO REDUCE THEIR SHARE OF THE COUNTERPART DEFICIT TO A FIGURE MORE IN LINE WITH THEIR DEBT SERVICING CAPACITIES. THE PROPER EEC SHARE OF THE REMAINDER IS SUGGESTED TO BE ABOUT \$5-7 BILLION FOR THE NEXT 3-5 YEARS.

5. THE COMMISSION PAPER THEN APPORTIONS THIS SHARE AMONG MEMBER STATES. GIVEN THE NEED OF THE UK AND ITALY TO MEET A HEAVY SCHEDULE OF DEBT REPAYMENTS OVER THE NEXT SEVERAL YEARS, AND THEIR RELATIVELY LOW RESERVES, BOTH

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COUNTRIES NEED TO RUN CURRENT ACCOUNT SURPLUSES OF FROM \$2-3 BILLION PER YEAR (AT CURRENT PRICES). FRANCE HAS INCURRED A GOOD DEAL LESS DEBT, AND APPROXIMATE BALANCE OR A SMALL DEFICIT (\$0-2 BILLION) WOULD BE APPROPRIATE. AMONG THE SMALLER COUNTRIES, THE DANISH POSITION NEEDS TO BE IMPROVED, BUT THE BENELUX COUNTRIES SHOULD PLAY THEIR PART IN THE ADJUSTMENT PROCESS BY MOVING INTO DEFICIT. THE NET DEFICIT OF THE SMALLER COUNTRIES SHOULD PROBABLY BE ON THE ORDER OF \$2-3 BILLION.

6. WITH THESE BALANCES ABOUT OFFSETTING, IT WOULD BE LEFT FOR THE FRG TO RUN AN ANNUAL DEFICIT OF FROM \$5-7 BILLION - A SUSTAINABLE LEVEL EQUIVALENT TO ABOUT 1 PER-CENT OF PROBABLE GERMAN GDP IN 1980.

7. AFTER A RATHER LENGTHY REVIEW OF PAST PROGRESS TOWARDS ADJUSTMENT OF CURRENT ACCOUNT POSITIONS, AND DECENT TRENDS IN EXCHANGE RATES AND COMPETITIVENESS, THE PAPER FORECASTS 1977 CURRENT BALANCE FOR THE FOUR

MAJOR COUNTRIES AS FOLLOWS: FRG SURPLUS 8 BILLION DM;
FRANCE DEFICIT 18 BILLION FR; ITALY DEFICIT 750 BILLION
LIRA; UK SURPLUS 300 MILLION POUNDS. THE PAPER THEN
PROJECTS CURRENT ACCOUNTS FOR 1980, BASED ON ASSUMED
GROWTH AIMS, THE GROWTH OF WORLD TRADE AND CONSTANT
RELATIVE PRICES. THESE PROJECTIONS (WHICH ARE NOT
PRESENTED AS MOST PROBABLE OUTTURNS) PUT FRANCE AND
THE UK CLOSE TO THEIR NORMS (A SMALL DEFICIT FOR FRANCE,
A SOMEWHAT "EXCESSIVE" SURPLUS FOR THE UK), AND THE FRG
IN DEFICIT, BUT WELL BELOW THE \$5-7 BILLION NORM. THE
MAJOR DISCREPANCY IS THAT FOR ITALY, WHICH IS SHOWN WITH

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A 1980 DEFICIT OF \$5 1/2 BILLION.

8. THE COMMISSION THEN DISCUSSES SOME POSSIBLE POLICY
IMPLICATIONS OF THIS ANALYSIS. THE MAGNITUDE OF THE
ITALIAN DISEQUILIBRIUM IS SEEN AS SUCH THAT A VERY COSTLY
REDUCTION IN GROWTH RATES (FROM 3 3/4 TO 2 1/2 PERCENT
PER ANNUM) WOULD BE REQUIRED TO ACHIEVE THE TARGETED
SURPLUS, WHILE FEEDBACK EFFECTS ON DOMESTIC PRICES MAKE
ADJUSTMENT OF COMPETITIVE POSITION THROUGH EXCHANGE RATES
VERY DIFFICULT. THE COMMISSION THEREFORE SUGGESTS THAT
THE GOAL OF AN ITALIAN SURPLUS IN THIS TIME FRAME MAY BE
UNREALISTIC, AND THAT INTERNATIONAL CREDIT SHOULD CON-
TINUE TO BE PROVIDED SO LONG AS ITALY DOES WELL IN
ACHIEVING DOMESTIC POLICIES AND PERFORMANCE.

9. THE UK IS DEPICTED AS FACING A LESS ACUTE DILEMMA,
CHOOSING BETWEEN ALLOWING ITS EXCHANGE RATE TO APPRECIATE
AS AN AID TO FIGHTING ITS STILL RAPID INFLATION, OR

ENCOURAGING IT TO FALL FURTHER TO MAINTAIN ITS COMPETITIVE POSITION. GIVEN THAT THE PROJECTED SURPLUS IS ON THE HIGH SIDE, HOWEVER, THE UK HAS SOME LEEWAY TO PERMIT SOME LOSS IN COMPETITIVENESS.

10. GERMANY MIGHT ACHIEVE ITS DESIRABLE RATE OF DEFICIT
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EITHER THROUGH A SOMEWHAT HIGHER GROWTH RATE (4.8 PERCENT, UP FROM 4.5 PERCENT) OR A MODEST FURTHER INCREASE IN RELATIVE PRICES. IT IS SUGGESTED THAT THE LATTER MIGHT BE HELPED ALONG THROUGH AN ACTIVE INTERVENTION POLICY OF SELLING DOLLARS.

11. MEMBER STATE REPRESENTATIVES SUBJECTED THE PAPER TO HEAVY CRITICISM DURING THE MEETING, ATTACKING ITS ASSUMPTIONS, PROJECTIONS, AND POLICY SUGGESTIONS. THE GERMAN REPRESENTATIVE LED THE WAY. FIRST, THE ASSUMPTION OF A CONTINUING LARGE OPEC SURPLUS WAS UNDULY RIGID. IF OTHER COUNTRIES WERE TO EMULATE THE FRG'S AGGRESSIVE SELLING EFFORTS, THE OPEC SURPLUS MIGHT WELL BE LOWERED A GREAT DEAL. FURTHERMORE, THERE WAS NO NEED TO ASSUME THE EC NEEDED TO ACCEPT ANY PARTICULAR SHARE OF ANY REMAINING COUNTERPART DEFICIT, ESPECIALLY SINCE NEARLY 50 PERCENT WAS A BILATERAL US-OPEC PROBLEM, AND THE US WAS ALREADY ABSORBING A LARGE DEFICIT. (MONETARY COMMITTEE PRESIDENT POEHL, HOWEVER, COMMENTED THAT THE US DEFICIT MIGHT BE GETTING TOO LARGE, AND POTENTIALLY DESTABILIZING.) THE GERMANS WOULD WILLINGLY ACCEPT A SWING TOWARDS DEFICIT IF THIS WERE BROUGHT ABOUT BY APPROPRIATE ADJUSTMENT MEASURES BY DEFICIT COUNTRIES OR BY MARKET FORCES, BUT THEY EMPHATICALLY REJECTED ANY SUGGESTION THAT ADJUSTMENT BE ACHIEVED THROUGH FORCING HIGHER GROWTH RATES OR BY AGGRESSIVE EXCHANGE-RATE MANAGEMENT.

12. THE FRENCH STRONGLY SUPPORTED THE VIEW THAT THE EC AS A WHOLE NEED NOT AIM FOR A CURRENT ACCOUNT DEFICIT. RATHER, AS A GROUP OF ADVANCED INDUSTRIALIZED COUNTRIES, THE EC SHOULD BE IN CURRENT ACCOUNT SURPLUS, EXPORTING CAPITAL AND REAL RESOURCES TO DEVELOPING COUNTRIES. THE US NEEDED TO TAKE ACTION TO CORRECT ITS OWN DEFICIT BY REDUCING OIL IMPORTS. FRANCE ITSELF WOULD CERTAINLY NOT AIM FOR A DEFICIT, BUT FOR A SURPLUS. ANY AGGRESSIVE INTERVENTION TO PUSH THE DM UPWARDS WOULD HAVE POTENTIALLY
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SEVERE UPSETTING EFFECTS ON MARKETS. THE LATTER POINT WAS GENERALLY ECHOED IN THE MEETING, PARTICULARLY BY GERMANY'S PARTNERS IN THE SNAKE. NO ONE EXPRESSED SUPPORT FOR AN AGGRESSIVE POLICY TO PRODUCE APPRECIATION OF THE DM.

13. THE UK AND ITALIAN REPRESENTATIVES TOOK A LESS UNFAVORABLE VIEW OF THE COMMISSION'S ANALYSIS, BUT ALSO QUESTIONED THE CONCLUSIONS. THE UK ARGUED THAT IT NEEDED A LARGER SURPLUS THAN SUGGESTED BY THE COMMISSION, AND THAT IT COULD NOT ALLOW THE LOSS OF COMPETITIVENESS IN MANUFACTURING THAT WOULD RESULT IF STERLING WERE TO APPRECIATE ON ACCOUNT OF ITS TEMPORARY OIL SURPLUS. THE ITALIANS VIEWED THE PROJECTIONS OF THE ITALIAN DEFICIT AS OVERLY PESSIMISTIC (FOR EXAMPLE, THE ASSUMED GROWTH RATE SHOULD HAVE BEEN 3 NOT 3 3/4 PERCENT), BUT TOOK A MORE FAVORABLE VIEW OF THE GENERAL THRUST OF THE PAPER. THEY EXPRESSED PREFERENCE FOR A HIGHER GERMAN GROWTH RATE OVER DELIBERATE APPRECIATION OF THE DM.

14. AFTER THE MORNING'S DISCUSSION, THE COMMITTEE ADJOURNED TO A LENGTHY LUNCHEON IN HONOR OF DEPARTING MEMBER EMMINGER. COMMISSION SOURCES WERE QUITE FRUSTRATED AT THE COMMITTEE'S RESPONSE TO THEIR PAPER (AND AT DIRECTOR GENERAL MOSCA'S UNWILLINGNESS TO CHALLENGE UNWARRANTED CRITICISM OF THE PAPER IN THE MEETING.) THEY WERE DISCOURAGED THAT MEMBER STATE REPRESENTATIVES WERE UNWILLING TO REALISTICALLY FACE THE ISSUES POSED BY THE PAPER. IT IS THOUGHT LIKELY THAT FUTURE PAPERS AND DISCUSSIONS IN THE MONETARY COMMITTEE WILL BE NARROWLY

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FOCUSED ON SHORT-TERM EXCHANGE MARKET DEVELOPMENTS. THIS
WOULD ALSO AVOID DUPLICATION OF EFFORTS IN WP/3.

15. COMMENT: THE COMMISSION'S ANALYSIS, PROJECTIONS,
AND POLICY CONCLUSIONS ARE ALL SUBJECT TO CRITICISM, OF
COURSE. HOWEVER, THE GENERAL ACCEPTANCE OF THE NEED FOR
THE OIL IMPORTING COUNTRIES TO ACCEPT THE COUNTERPART OF
THE OPEC SURPLUSES PROBABLY HELPED TO AVOID BEGGAR-THY-
NEIGHBOR POLICIES IN THE YEARS FOLLOWING THE OIL PRICE
INCREASES. THEREFORE, THE REPORTED UNWILLINGNESS OF SOME
IMPORTANT MEMBER STATES TO ADMIT TO THE SUITABILITY OF
CURRENT ACCOUNT DEFICITS FOR THEMSELVES OR FOR THE EC IS
A BIT SURPRISING AND SOMEWHAT DISTURBING. ALSO INTEREST-
ING ARE THE HORRIFIED REACTIONS TO COMMISSION SUGGESTIONS
FOR A MORE ACTIVE INTERVENTION POLICY WHEN COMPARED WITH
PAST CALLS FROM SOME EUROPEAN QUARTERS FOR STRONGER
MANAGEMENT OF EXCHANGE RATES. END COMMENT. HINTON

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